

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Robert G. Taub, Vice Chairman;
Mark Acton;
Tony L. Hammond; and
Nanci E. Langley

Complaint of GameFly, Inc.

Docket No. C2009-1R

ORDER CONVENING SETTLEMENT CONFERENCE

(Issued April 16, 2013)

I. INTRODUCTION

The latest issues in this docket come before the Commission on remand from the United States Court of Appeals for the District of Columbia.¹ Following the issuance of the Court's mandate, on March 7, 2013, GameFly, Inc. (GameFly) filed a motion requesting the Commission to establish standards and procedures for proceedings on remand.²

¹ *GameFly, Inc. v. Postal Regulatory Commission*, 704 F.3d 145 (D.C. Cir. 2013) (*GameFly*).

² Docket No. C2009-1, Motion of GameFly, Inc., to Establish Standards and Procedures to Govern Proceedings on Remand, March 7, 2013 (GameFly Motion).

The Postal Service replied to the GameFly Motion and GameFly filed a response.³ For the reasons discussed below, the Commission defers action on these filings and will convene a settlement conference to pursue the possibility of the parties agreeing to a mutually acceptable resolution of the remaining issues in the remanded proceeding. The settlement conference will convene at 10:00 a.m. April 23, 2013 in the Commission's hearing room.

II. BACKGROUND

Proceedings in this docket were instituted by GameFly's filing of a complaint under 39 U.S.C. § 3662. In its complaint, GameFly alleged that rates and services offered by the Postal Service to certain DVD mailers violated prohibitions on undue or unreasonable discrimination under 39 U.S.C. §§ 101(d), 403(c), 404(b), and 3622(b)(8).⁴

GameFly, which is in the business of renting video game DVDs, alleged that the Postal Service discriminated against GameFly by not providing the same treatment to GameFly's mail as it did to the mail of Netflix and Blockbuster (which are primarily in the business of renting movie DVDs). *Id.* at 12. GameFly alleged further that the Postal Service manually culled and processed Netflix and Blockbuster's mail, allowing them to mail one-ounce First-Class letters without paying a non-machinable surcharge or exposing their DVDs to the risk of breakage on automated machines. *Id.* at 8-9. GameFly asserted that, unlike Netflix and Blockbuster, it decided to add a protective cardboard insert and mail its DVDs as two-ounce First-Class flats in order to avoid automated machines and reduce the risk of breakage. *Id.* at 5. At the time the

³ See United States Postal Service Reply in Opposition to Motion of GameFly, Inc., to Establish Standards and Procedures to Govern Proceedings on Remand, March 14, 2013 (Postal Service Reply); Response of GameFly, Inc., to March 14 USPS Opposition to GameFly Motion to Establish Standards and Proceedings on Remand, March 18, 2013 (GameFly Response). Accompanying the GameFly Response was a motion requesting leave to respond to the Postal Service Reply. Motion of GameFly, Inc., for Leave to Respond to March 14 USPS Opposition to March 7 GameFly Motion, March 18, 2013. The motion for leave to respond is granted.

⁴ Docket No. C2009-1, Complaint of GameFly, Inc., April 23, 2009, at 1 (Complaint).

Complaint was filed, the First-Class one-ounce letter rate was \$0.42 and the First-Class two-ounce flat rate was \$1.00. *Id.* at 6.

Determination of undue discrimination. After extensive discovery, testimony, filings, and hearings, the Commission issued an order in which it determined that the Postal Service had unduly discriminated against GameFly.⁵ The Commission reached this conclusion by using a three-part test that considered whether: (1) GameFly had been offered less favorable rates or terms and conditions than another mailer; (2) GameFly was similarly situated to the other mailer; and (3) there was no rational or legitimate basis for the Postal Service to deny it the more favorable rates or terms or conditions provided to the other mailer. *Id.* at 28. The Commission determined that all three prongs of the test had been satisfied. *Id.* at 108.

GameFly's proposed remedies. Although it found that the Postal Service had unduly discriminated against GameFly, the Commission rejected the two remedies suggested by GameFly. The first was an operational remedy that would have required the Postal Service to offer "a measurable and enforceable level of manual culling and processing of DVD mailers sent at machinable letter rates." *Id.* at 110. The Commission explained that it was reluctant to assume responsibility for oversight of Postal Service operations at the level proposed by GameFly and wary of the "significant administrative costs" that the Postal Service could incur attempting to enforce a particular level of manual culling and processing. *Id.* at 111.

GameFly's second proposed remedy was a rate-based remedy, under which the Postal Service would have been required to publish a reduced rate for flat-shaped DVD mailers designed to produce the same average contribution per piece for both flat-shaped and letter-shaped DVD mail (the "equal contribution remedy"). *Id.* The Commission rejected this second proposed remedy because the models used by GameFly's witness in support of this remedy were "not sufficiently accurate" to establish an appropriate rate. *Id.* at 112. The Commission stated a preference for allowing the

⁵ Order on Complaint, April 20, 2011, at 108 (Order No. 718).

Postal Service, rather than the Commission, to “exercise statutory flexibility” in ratemaking and expressed concern that the rate-based remedy “fails to directly address the consequences of the preferential treatment afforded Netflix.” *Id.* at 112-113.

Commission remedy. In lieu of GameFly’s proposed remedies, the Commission opted to establish a “niche classification” for round-trip DVD mail. *Id.* at 113. Order No. 718 added a “Letter Round-Trip Mailer” category and a “Flat Round-Trip Mailer” category to the Mail Classification Schedule (MCS). *Id.* Appendix B. The Letter Round-Trip Mailer category allowed round-trip DVD mailers to send one-ounce letter-shaped mail at the single-piece machinable letter rate and prevented the Postal Service from applying a non-machinable surcharge to such mail. *Id.* at 1. The Flat Round-Trip Mailer category allowed round-trip DVD mailers to send flat-shaped mail of up to two ounces at the one-ounce single-piece First-Class flats rate. *Id.* at 2. The Commission characterized this remedy as providing GameFly with treatment comparable to the treatment the Postal Service gave Netflix. *Id.* at 114. However, the remedy also resulted in a higher rate and a higher per-piece contribution for round-trip DVD mail sent as flats. *Id.* at 115. The Commission found the higher rates and contribution to be justified by “cost differences and by general pricing differences between First-Class Mail flat and letter products.” *Id.*

D.C. Circuit Opinion. Unsatisfied with the remedy imposed by Order No. 718, GameFly filed an appeal with the Court. The Postal Service elected not to appeal the Commission’s finding of undue discrimination, but did participate in the appellate proceedings in support of the remedy prescribed by Order No. 718.

The Court rejected the Commission’s remedy because it left in place part of the discrimination it was attempting to remedy without explaining why the “residual discrimination” was due or reasonable. 704 F.3d at 149. The residual discrimination identified by the Court consisted of continuing differences in the terms of service offered to DVD mailers of letter-shaped and flat-shaped mail. The Court explained that the Commission “cannot justify the terms of service discrimination its remedy leaves in place (providing manual letter processing to Netflix but not to GameFly) based on the

companies' use of different mailers when the use of different mailers is itself the product of the service discrimination." *Id.*

The Court vacated the Commission's order and remanded the case to the Commission to "either remedy all discrimination or explain why any residual discrimination is due or reasonable under § 403." *Id.* It expressed the opinion that the Commission would "surely consider" GameFly's proposed remedies on remand, but noted that "there may be a range of other possible remedies which would withstand appellate review." *Id.*

III. GAMEFLY MOTION, POSTAL SERVICE REPLY, AND GAMEFLY RESPONSE

In response to *GameFly*, the parties filed a series of documents setting out their respective positions and expectations for proceedings on remand. The first of these was the GameFly Motion, followed by the Postal Service Reply and the GameFly Response.

GameFly Motion. The GameFly Motion begins by outlining the issues that GameFly considers to have been resolved by the Court's Opinion. GameFly Motion at 1-8. It then sets forth a new proposed remedy and several possible alternatives, as well as the standards and procedures that GameFly asserts should be used to evaluate any alternative remedies. *Id.* at 8-18.

GameFly's new remedy would require the Postal Service to charge the First-Class Mail letter rate for all round-trip DVD mailers, whether they choose to mail letters or flats. *Id.* at 9. GameFly characterizes this remedy as "the next best alternative" to requiring the Postal Service to provide GameFly's mail with the same degree of manual processing that Netflix receives for its letter-shaped DVD mail. *Id.* at 11. In proposing this remedy, GameFly withdraws its previous request for the equal contribution remedy. *Id.* GameFly argues that the Commission should impose its new remedy immediately, without re-opening the record in this docket. *Id.* at 13.

GameFly also identifies two alternatives to its new, preferred remedy. The first of these alternatives would allow the Postal Service 30 days to propose a rate for DVD

mailers that is the same for both flats and letters but higher than the preferred remedy's First-Class Mail letter rate. *Id.* at 14. GameFly asserts that the Postal Service should be required to provide certain additional information to support any such proposed rate. *Id.* If the Postal Service were to choose not to submit a proposed new rate within 30 days, GameFly would have the Commission establish a new rate for both letter- and flat-shaped DVD mail at the First-Class Mail letter rate. *Id.*

GameFly's second proposed alternative remedy is an operational remedy that would require the Postal Service to either provide the same level of manual processing to Netflix and GameFly mail or to discontinue manual processing of Netflix mail. *Id.* at 15. GameFly argues that the record in this docket "imposes a heavy presumption" against an operational remedy, citing potential problems with enforcement. *Id.* at 15-16. GameFly suggests that if the Commission adopts an operational remedy, the Postal Service should be required to provide certain information in support of that remedy. *Id.* at 17-18.

Postal Service Reply. The Postal Service Reply rejects the remedies proposed in the GameFly Motion, arguing instead that the Commission should maintain its original remedy, but explain better why that remedy addresses any residual discrimination. Postal Service Reply at 2, 10-14. The Postal Service also takes issue with GameFly's list of settled issues, asserting that GameFly is attempting to eliminate the Commission's discretion and authority by preventing the Commission from re-opening the record and obtaining additional guidance. *Id.* at 2.

The Postal Service asserts that the record contains sufficient evidence for the Commission to explain to the Court's satisfaction that its original remedy was sound and that any remaining discrimination is due to local operational decisions dictated by differences in the volume, density, and appearance of Netflix's and GameFly's mail. *Id.* at 11-12.

The Postal Service argues further that any rate-based remedy would require the Commission to re-open the record to conform with "statutory and regulatory provisions governing the establishment of rates and classifications under the [Postal Accountability

and Enhancement Act]” and to respect the Postal Service’s authority to direct its own operational policies. *Id.* at 6. It states that the record in this docket lacks sufficient evidence to support GameFly’s proposed rate-based remedy. *Id.* at 6-7. The Postal Service warns that GameFly’s remedy would “inevitably lead to questions about the presence and effects of discrimination embodied in all rates, and the Mail Classification Schedule in general.” *Id.* at 8.

Finally, the Postal Service argues that the record does not reflect changes in the processing of DVD mail and “major parts of the operating environment” that have occurred since the record in this docket was established. *Id.* at 9.

GameFly Response. GameFly responds to the Postal Service Reply by reiterating its position that the Postal Service is not permitted to relitigate factual issues resolved by Order No. 718 (either before the Commission or before the Court in a future appeal) or the findings of *GameFly*. *GameFly Response* at 4-6.

GameFly concedes that there may be alternative remedies available that would require the Commission to re-open the record. *Id.* at 8. However, GameFly asserts that the degree to which the record should be re-opened will depend on the particular alternative remedy. *Id.* For instance, GameFly believes that its first alternative remedy (price equalization at a rate established by the Postal Service) would require little additional information, but that its second alternative remedy (operational directives) may require “more elaborate fact-finding.” *Id.* at 8-9.

GameFly contends that, rather than attempting to place substantive limits on potential remedies, it is proposing filing requirements designed to elicit the information necessary to support an alternative remedy. *Id.* at 9. It asserts that each of these filing requirements is reasonable in light of the nature of the proposed alternative remedies. *Id.* at 10. In particular, it asserts that because the Postal Service argued against an operational remedy in earlier proceedings in this docket, the Postal Service must make additional showings if it now believes an operational remedy is justified. *Id.*

Finally, GameFly argues that a remedy that equalized rates for letter- and flat-shaped DVD mailers is neither discriminatory against other flat-shaped mail nor

likely to have a significant impact on the Postal Service's financial situation. *Id.* at 11-12.

IV. ANALYSIS

The Commission has before it several remedies which the parties believe would satisfy the court's directive to "either remedy all discrimination or explain why any residual discrimination is due or reasonable under § 403." 704 F.3d at 149. GameFly prefers a remedy that establishes an identical rate for round-trip DVD letter and flats mail that is equal to the First-Class Mail letter rate. GameFly Motion at 8-13. The Postal Service vigorously opposes GameFly's preferred remedy and encourages the Commission to stand by the remedy prescribed by Order No. 718. Postal Service Reply at 4-5, 10-11 ("there is sufficient evidence in the existing record to support the original remedy, and the Commission has the authority to conduct proceedings for that purpose, if necessary.").

The Court has given the Commission sufficient latitude to consider both of these remedies, as well as others including the two remedies originally proposed by GameFly. 704 F.3d at 149 ("Upon rehearing, the Commission will surely consider those [*i.e.*, GameFly's earlier] remedies, but there may be a range of other possible remedies which would withstand appellate review."; "The Commission must either remedy all discrimination or explain why any residual discrimination is due or reasonable under § 403.>").

The Commission is considering various remedies, each of which is intended to satisfy the Court's directive. The Commission has identified, at least preliminarily, the following options:⁶

GameFly proposed remedies:

- *An equal rate remedy;*
- *An equal contribution remedy;*

Postal Service proposed remedy:

- *Original remedy set forth in Order No. 718 with additional explanation as to why the residual discrimination is justified;*

Remedies identified by the Commission:

- *A remedy that retains the Letter Round-Trip DVD Mailer and Flat Round-Trip DVD Mailer categories created by Order No. 718, imposes a requirement that the Postal Service manually process all letter-shaped DVD mail, and establishes an enforcement mechanism to ensure manual processing is occurring at a certain level;*
- *An operational remedy that would eliminate all special treatment of DVDs and impose rates that apply to the mailpiece, e.g., the non-machinable surcharge and second ounce rates; and*
- *An operational remedy that would require manual handling of all letter-shaped DVDs subject to certain standards.*

The Appendix provides a brief description of these alternatives. The options outlined above do not foreclose the parties from fashioning their own mutually agreeable relief.

⁶ There is no significance to the order in which the options are presented. As noted below, the Commission has made no decision about any possible remedy.

The parties take different positions on whether, and to what extent, further administrative hearings (including additional discovery) might be necessary to resolve the remedy issue. GameFly advocates the immediate imposition of its preferred rate-based remedy on the basis of the existing record. GameFly Motion at 12. The Postal Service appears to advocate a re-opening of the record to revisit many of the issues decided in Order No. 718. Postal Service Reply at 5-8.⁷

Given the significant differences between their positions on remand, the parties could be headed toward further prolonged administrative and appellate review proceedings. Such a result is neither in the public interest nor the best interest of a sound administrative process. This prolonged proceeding has already consumed substantial resources of the parties and the Commission. There is no assurance that a Commission imposed remedy will be satisfactory to both parties. The Commission believes that it is in the public interest and prudent for all concerned to explore the possibility of resolving the remedy issue by settlement. Accordingly, the Commission is convening a settlement conference to be attended by representatives of GameFly, the Postal Service, intervenors, and the Public Representative previously appointed to this proceeding.

The Commission takes this step with the hope that a better sense of the remedies under consideration on remand may allow the parties to address their differences and reach a mutually agreeable outcome. As yet, the Commission has made no decision on a possible remedy and expresses no preference among those described in this Order. It fully expects that the parties will make the most of this opportunity to fashion a remedy acceptable to both without the unnecessary use of time or resources.

⁷ Without, at this juncture, ruling on the propriety of revisiting any of these subjects in the context of developing a remedy, the Commission notes that its finding of undue discrimination, which was not challenged by the Postal Service in the appellate proceedings, is final and has not been remanded by the Court for further Commission consideration.

V. SETTLEMENT PROCEDURES

Initial meeting. Pursuant to 39 C.F.R. § 3030.40, the Commission will convene a settlement conference on April 23, 2013. To facilitate discussions, the Commission appoints James Waclawski as settlement coordinator. In discussing the possibility of settlement, the parties are free to consider the remedies identified above and any others they deem appropriate. Among the factors they should bear in mind is the desirability of avoiding an unnecessary re-opening of the record.

Expeditious proceedings. Time is of the essence. The purpose of these settlement discussions is to allow the parties an opportunity to identify a mutually agreeable remedy as expeditiously as possible. The Commission has no desire to delay unnecessarily the resolution of the outstanding issues in this docket. To that end, the Commission directs the settlement coordinator to discourage dilatory behavior by the parties and to notify the Commission as soon as possible if he determines that negotiations between the parties are unlikely to be fruitful. The settlement coordinator shall file a report on the progress of settlement not later than 20 days after the issuance of this Order.

Should the parties fail to agree on an appropriate remedy, the Commission will rule on the GameFly Motion and will proceed with all reasonable dispatch to complete the remand proceeding and satisfy its obligation “either to remedy all discrimination or to explain why any discrimination it left in place was due or reasonable under § 403(c).” 704 F.3d at 148. Whether further administrative proceedings will be needed to create a record adequate to support the remedy ultimately selected by the Commission is a matter that will be determined by further order of the Commission.

It is ordered:

1. The Commission convenes a settlement conference at its offices at 10:00 a.m. on April 23, 2013, for the purpose of reaching agreement on a remedy of the undue discrimination previously found to exist by Order No. 718.

2. The Commission directs GameFly and the Postal Service to immediately engage in settlement negotiations with the goal of expeditiously resolving this controversy based on the potential remedies and considerations discussed in this Order.
3. The Commission appoints James Waclawski as settlement coordinator concerning the settlement discussions ordered herein and to coordinate those discussions.
4. The Commission directs the settlement coordinator to file a report not later than 20 days after the date of this Order.
5. Emmett Rand Costich, previously appointed in this proceeding as Public Representative, shall continue in that capacity to represent the interests of the general public.
6. The Commission directs the Secretary of the Commission to arrange for publication of this Order in the *Federal Register*.

By the Commission.

Ruth Ann Abrams
Acting Secretary

Summary Descriptions of Potential Remedies

I. GameFly proposed remedies:

a. Equal rate treatment.

Rates for letter- and flat-shaped DVD mail at the First-Class Mail letter rate would be equalized either at the current first ounce letter rates or at rates higher than the First-Class Mail letter rate.

b. An equal contribution remedy.

An equal contribution remedy would reduce rates for flat-shaped DVD mail to a level that would produce an equal contribution for letter- and flat-shaped DVD mail. The Commission rejected GameFly's proposed equal contribution remedy, in part, on the limitations of the then-current record.⁸ This option may require the parties to develop supplemental or revised cost data to address the deficiencies of the then-record data.

II. Postal Service proposed remedy:

A remedy that would require an explanation of why any residual discrimination is due or reasonable, such as the Commission's original remedy. This would preserve the remedy adopted in Order No. 718, permitting DVD mailers either to send one-ounce letter-shaped mail without paying a non-machinable surcharge or to send flat-shaped mail of up to two-ounces at the applicable one-ounce single-piece First-Class flat rates. Order No. 718 at 1-2. This remedy could require the Commission to provide a more extensive and persuasive explanation of the rationale for any remaining discrimination in order to withstand further appellate review.

⁸ Order No. 718 at 112, ¶ 5019 ("Even if the Commission were to accept GameFly's contention that the cost differences do not justify the extent of the difference in rates paid by the mailers, such estimates are not sufficiently accurate to be used to design a rate for flat-shaped round-trip DVD mailers in the manner suggested by GameFly's rate-based remedy.").

III. Remedies identified by the Commission:

- a. Retain the Letter Round-Trip DVD Mailer and Flat Round-Trip DVD Mailer categories, impose a requirement that the Postal Service manually process all letter-shaped DVD mail, and establish an enforcement mechanism to ensure manual processing is occurring at a certain level.*

This remedy would retain the Letter Round-Trip Mailer and Flat Round-Trip Mailer categories and rates as established in Order No. 718. It would require the Postal Service to provide manual processing for all letter-shaped DVD mail and it would establish an enforcement mechanism to ensure that a certain level of manual processing was in fact provided. Mailers who are satisfied with the prescribed level of manual processing could send their DVDs as letter mail. Mailers who are not satisfied with the prescribed level of manual processing could send DVDs as flats and would get the second ounce free. If this remedy were adopted, mailers could choose the type of mail service that gives them the level of protection they desire.

- b. An operational remedy that would eliminate all special treatment of DVDs and impose rates that apply to the mailpiece, e.g. the non-machinable surcharge and second ounce rates.*

This remedy eliminating all special treatment of DVDs would require the Postal Service to collect a non-machinable surcharge on all letter-shaped DVD mail. The Letter Round-Trip Mailer and Flat Round-Trip Mailer categories established in Order No. 718 would be eliminated and the Postal Service would impose the full charge for the second ounce of First-Class DVD flats mail.

- c. An operational remedy that would require manual handling of all letter-shaped DVDs subject to certain standards.*

The remedy would require the Postal Service to provide uniform manual processing to all letter-shaped DVD mail, *e.g.*, the type afforded Netflix's mail. The non-machinable surcharge would not be imposed. However, the Letter Round-Trip Mailer and Flat Round-Trip Mailer categories would not be retained.

While manual processing of DVD letter mail would be made available to all mailers on a non-discriminatory basis, it nevertheless would recognize that operational factors can affect the feasibility of providing manual processing at any point in time and that individual mailers cannot be guaranteed the exact same level of manual processing. This recognition that manual processing levels may fluctuate and vary from mailer to mailer distinguishes this operational remedy from the GameFly operational remedy that would require that each mailer receive the same level of manual processing. Enforcement of the requirement that such manual processing be provided on a non-discriminatory basis could be facilitated by requiring the Postal Service to monitor and report manual processing levels, *e.g.*, based on IMb scans.